THE RULE IN THE CLARKSON HOME CASES.

In May, 1905, the Court of Appeals of New York handed down in some allied cases a decision which affects in a practical manner all corporations that transfer their stock and register their bonds or act as agents of other corporations for the like purposes. The purchase and sale of securities is continually increasing in volume and the law on the subject increasing accordingly in practical importance. The decision appears to settle the law in New York on the points involved and, in view of the especially high standing of this jurisdiction in the law governing financial transactions, may be followed elsewhere. Moreover, the decision turned upon some of the general principles of agency rather than upon any doctrines peculiar to New York. In the light of these considerations, it may be of interest to inquire briefly into the soundness of the learned Court's position.

The facts of the case were substantially as follows:[1] An incorporated charitable institution, the Clarkson Home, kept securities owned by it in a safe deposit vault in New York City, to which the president and treasurer of the Home each had a key and free access. Among the holdings were some coupon bonds of various railroads which, by way of precaution, the corporation had had registered as to principal in its name. In 1900 one L became the treasurer. In 1902 he removed the bonds in question from the box, took them to a broker G, and said that the Home desired to sell them. G's cashier, observing that they were registered, told L to take them to the railroad company which issued them and find out the requirements for transferring the bonds to bearer in order to render them transferable by delivery. L did so and was told that he would have to have a resolution of the board of directors of the Home adopted, authorizing the sale, and file a copy certified by the secretary under the corporate seal with the railroad company. Also he would have to have a power of attorney executed by the Home, with the signature guaranteed by some Stock Exchange house. L returned to G, produced a paper which purported to be a copy of the resolution that was demanded, attested by the secretary and sealed with the corporate seal. This document was from beginning

[1] Clarkson Home *v.* M. K. & T. Ry. Co. (1905) 182 N. Y. 47, and cases affd. without opinion by references to the principal case, *id.* 506, 507.

to end a forgery by L. No such resolution had been adopted. He also signed the power of attorney to make the transfer in the corporate name by himself as treasurer, and this signature was guaranteed by the broker G. With the requirements thus fulfilled the bonds were transferred by the issuing company to bearer, were then sold and the proceeds misappropriated by L, who absconded. Upon discovering the foregoing facts, the Home brought suit against the railroad and the brokers, and it was held that duplicate bonds or their value should be delivered to the plaintiff by the railroad company.[1]

The Court declared that the law upon the question was elementary and after examining and approving the ruling in two cases,[2] summed up the reasoning in this way:

"It thus appears that the test as to the liability of the principal for the acts of his agent is as to whether the acts were committed in the course of his employment and within the scope of his agency. * * * He (L) was the treasurer of a charitable corporation, engaged in no commercial business where he had been held out to the public as possessing the power to sell or transfer stock, bonds or other securities of the company * * * by which third parties had been induced to believe that he possessed such authority and thereby induced to part with their property. Indeed, it is apparent that the defendants did not trust him or act upon any implied authority by virtue of his office to sell and dispose of the bonds, [because they had demanded the resolution of authority]. * * * We, therefore, think that the facts in this case bring it within the rule recognized in the latter case referred to, in which it was held that the corporation was not liable for the acts of its officers."[3]

Now, apart from legal technicalities, both the Home and the railway company were of course absolutely innocent of intentional wrong-doing or even of negligence. But the Court felt constrained to applying an established formula to take the loss from the Home on whom it had fallen and impose it upon the railway company. Assuming for the moment that the reasoning was correct, does the result appear wholly satisfactory? Perhaps this may be tested by glancing at the probable results of placing the responsibility upon the issuing company.

It is desirable, of course, that the transfer of stocks and registered bonds be made as simple and expeditious as possible. In all the great financial centers this transferring constitutes an industry by itself, and the public usually regard the agencies for the purpose as already too technical in their demands. Anyone

[1]We are not considering in this paper the liability of the broker on his guarantee.

[2]Fifth Ave. Bank *v.* 42nd St. etc. Ry. (1893) 137 N. Y. 231. Manh. Life Ins. Co. *v.* 42nd St. etc. Ry.(1893) 139 N. Y. 146.

[3]Loc. cit. 58-59.

who has been connected with an office where many such transactions take place will attest the bitter complaints that applicants make from time to time about the severity of the "requirements," and the papers necessary to be furnished before their wishes are granted. Whatever tends to increase the measure of their responsibility, and declares that they act "at their peril" unless they indulge in difficult and tedious research, impedes by so much the transaction of the business for which they are employed.

Upon the other hand, like the average individual, non-mercantile corporations, such as charitable institutions, almost invariably attend to their affairs in a less business-like manner than is the case with a railway company. In the nature of things it is practically impossible to find men who are so constituted that they will take the same continuous and detailed interest in a volunteered matter as in one in which they are financially interested. And those who have the active management are very apt to be less carefully trained in the necessity for attention to detail. In a financial institution division of labor is not only methodical but to a large extent standardized so that it might easily seem to a third person odd that a certain official, say the treasurer, is attending to a department ordinarily presided over in similar institutions by the vice-president. But in the non-mercantile associations it is rare to find such system, and any officer is as apt as another to take charge of a matter. The desirable path to follow would therefore appear to be one which would not render transfer agencies unduly technical and obstructive in order to protect themselves, and which, at the same time, would impress upon the unbusiness-like the necessity for taking upon themselves ordinary precautions.

There were at least two methods whereby the fraudulent act of the treasurer might have been obviated. The Home might have taken greater care of its securities, or the transfer agent might have investigated the genuineness of the certified copy of the directors' resolution and have instituted an exhaustive inquiry into the propriety of the transaction. In addition to the delay and difficulty of such a procedure, which would probably have aroused the irritation rather than the gratitude of the Home's directors, had they really authorized the sale, there was, as a practical matter, no possible reason for suspecting the integrity of the treasurer. His mission was a wholly reasonable one, he admittedly was an officer and he produced apparently proper credentials. Besides, he had the bonds in his possession. He

had had free access to the deposit box, and neither the railway company nor any other third person could have questioned his right to their custody. To say under such circumstances that the company acted "at its peril," in not challenging his authority further, seems to disregard human nature. The man's position and the custody of the securities inevitably gave him a standing just as membership in a prominent club reduces scrutiny, while the rule adopted declares that those who are systematic must become yet more particular and that those who are less careful are to be protected in their easy-going methods. If the Court had arrived at a different conclusion and had left the loss where it was found, would not the result have heen equally reasonable and the moral effect far better? It is not conceivable that the railroad company would relax any of its requirements, while the Clarkson Home and all other institutions of a similar character would make haste to provide a system of reasonably secure checks whereby a recurrence of the defalcation would be rendered extremely difficult, if not impossible. Why should it not be required, for example, that no one official acting alone could gain access to the securities? Such a limitation is a very usual one and would greatly reduce the danger of theft.

This is the "practical" side of the matter, with a view to the improvement of methods. But it seems to the writer that the Court might have decided the cases the other way upon technical grounds as well. In the first place the Court said that L had not been "held out" as having authority to sell the bonds, nor did the railway company make this assumption because they demanded a copy of the resolution of authority. As to the first point it seems to the writer that the court confined what may be a "holding-out" to too narrow limits. A "holding-out," resulting in an estoppel of the principal, is held to arise from an apparent general authority with which an official is clothed solely by virtue of his official connection.[1] This rule, it is believed, might have been applied in the present cases.

It is a sufficiently curious result, flowing from the Court's interpretation of the facts in its discussion of the second point in the case that, if the railroad company had been less careful to inquire into L's authority, they might have been in a better position. In other words the Court counts against them the fact that they made inquiries as to L's right to effect the sale. However, it is a matter of common knowledge, among all who are

[1] Daniel on Neg. Instr. 4th Ed. §389.

familiar with transfer agencies, that such a resolution is always demanded as a record, without regard to the official presenting it. The request has little bearing upon their understanding of the powers of the agent, one way or the other. It is a question of documentary evidence, required whenever securities stand in a corporate name.

Now, there is a well-settled rule in New York which appears to be approved by text book authorities,[1] that when "the principal has clothed his agent with power to do an act upon the existence of some extrinsic fact necessarily and peculiarly within the knowledge of the agent, and of the existence of which the act of executing the power is itself a representation, a third person dealing with such an agent in entire good faith, pursuant to the apparent power, may rely upon the representation, and the principal is estopped from denying its truth to his prejudice."

This doctrine was formulated in the case of the *Bank of Batavia v. New York, Lake Erie & Western R. R. Co.*[2] In that case a station agent of the defendant had authority to issue bills of lading to shippers for freight consigned, *upon receipt of the goods.* Conspiring with one W the agent issued to W bills of lading on goods which had not been received, and W borrowed money on them from the plaintiff. The defendant principal was held liable.

A fair paraphrase of the reasoning is that the agent, if anyone, was the proper person to issue bills of lading. Whether in a particular case he had authority, was peculiarly within his own knowledge. By executing the bills he represented that the circumstances *did* authorize him. Now, in the Clarkson cases, although it is said that L was not "held out" as having authority, it does not seem to have been disputed that L was the proper person to sell the bonds, if they were to be sold. The spurious resolution, so far as appears, did not direct *him* to sell, but merely ordered the bonds sold, leaving it to the proper officers to complete the transaction. No question apparently was raised by either party or suggested by the Court as to the sufficiency of the power of attorney signed by L. In other words, if the sale of the bonds were authorized, as the issuance of the bills of lading was authorized in the Batavia Bank case, if the freight had been received, L was empowered to carry out the transaction, as the freight agent had been authorized to issue bills. In the one case

[1] Mechem on Agency §717.
[2] (1887) 106 N. Y. 195.

the agent by *implication only* represented that he had authority and the principal was held; in the other he *explicitly* did so by presenting the forged resolution. And yet in this stronger case the Court held the principal *not* bound.

It might be said that this discussion merely takes issue with the Court upon the facts. But all the facts which formed the basis of the decision are set forth fully and, as seems legitimate, we have rather attempted to criticise the conclusions of law drawn from them upon the grounds of business policy as well as upon technical reasoning. In brief, it appears to the writer that the rule adopted was inequitable and it is to be hoped that it will not be extended.

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